The Corporate Counsel

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Joint Standard 2 of 2020: Margin requirements on non centralised Over The Counter (OTC) derivative transactions

In June 2020, the Financial Sector Conduct Authority **(the FSCA)** and the Prudential Authority **(the PA)** acting in concert with the South African Reserve Bank published a Joint Standard 2 of 2020 which prescribes the Margin Requirements for non-centrally cleared over-the-counter **(OTC)** derivative transactions **(Joint Standard)**.

The Joint Standard applies to a provider entering into non-centrally cleared OTC derivative transactions with a counterparty.

The Joint Standard requires OTC derivative providers to calculate based on the relevant amount of counterparty credit risk and the exposure arising from its non-centrally cleared OTC derivative transactions, the initial margin and the variation margin. It also requires OTC derivative providers to have in place processes, board-approved policies and procedures that are sufficiently robust in respect of the relevant OTC derivative transactions. In addition to that they are required to have dispute resolution procedures with its relevant counterparties before the commencement of any relevant transaction and all margin transfers may be subject to a minimum amount of the sum of initial and variation margin which does not exceed 5 million.

Any cash and non-cash collateral that is collected as initial margin may be rehypothecated, re-pledged or re-used only once by the initial margin collector in accordance with conditions stipulated in the Joint Standard. It also lists assets and instruments such as cash, gold as well as assets and instruments that may be specified by the Authorities that qualify as eligible collateral. The goal is to mitigate the potential systemic risk surrounding OTC derivatives trading that may arise and to promote effective and sound risk management hence the imposition of robust collateral requirements.

A concern for counterparties however, would be the liquidity impact that would arise from the need to provide high-quality collateral to meet those requirements, including potential changes to market functioning as a result of an increasing demand for such collateral. Financial institutions may need to obtain and deploy additional liquidity resources to meet margin requirements that exceed current practices.

It is advisable that all providers to whom the Joint Standard will apply take steps to conduct a gap analysis and ensure that they are prepared to comply with the Joint Standard once the Effective Date is determined by the FSCA and PA.

Compliance will be phased-in. The Effective Date will be determined by the FSCA and Prudential Authority, however such Effective Date has not been proclaimed to date.

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